# In the Supreme Court of the United States.

October Term, 1921.

No. [redacted]53

W. TRINIDAD, as Insular Collector of Internal Revenue of the Philippine Islands, *Petitioner,*

*vs.*

SAGRADA ORDEN DE PREDICADORES DE LA PROVINCIA DEL SANTÍSIMO ROSARIO DE FILIPINAS, *Respondent.*

## PETITIONER'S BRIEF ON THE MERITS

GRANT T. TRENT,
*Lieutenant-Colonel, Judge Advocate.*
LOGAN N. ROCK,
*Captain, Judge Advocate.*
*Attorneys for Petitioner.*

Of Counsel,
NELSON T. HARTSON,
*Solicitor, Internal Revenue.*
F. GRANVILLE MUNSON,
*Major, Judge Advocate.*

# In the Supreme Court of the United States.

October Term, 1921.

No. 423

W. TRINIDAD, as Insular Collector of Internal Revenue of the Philippine Islands, *Petitioner,*

*vs.*

SAGRADA ORDEN DE PREDICADORES DE LA PROVINCIA DEL SANTÍSIMO ROSARIO DE FILIPINAS, *Respondent.*

## PETITIONER'S BRIEF ON THE MERITS.

## STATEMENT OF THE CASE.

This case is here on *certiorari* to the Supreme Court of the Philippine Islands for the review of a judgment of that court holding illegal the collection of certain income taxes and ordering the petitioner, defendant below, to refund the same to the respondent, plaintiff below, together with legal interest from October 10, 1919.

On October 10, 1919, the petitioner, as Collector of Internal Revenue of the Philippine Islands, demanded of the respondent, a corporation sole, constituted under sections 154 to 164 of Act No. 1459 of the Philippine Commission, the sum of 1,541.31 pesos as income tax corresponding to the period from March 31, 1913, to December 31, 1913, which the latter paid under protest. To recover back this amount, together with legal interest and costs, the present action was commenced in the Court of First Instance of the City of Manila, P. I., on April 6, 1920. From a judgment of that court, granting the prayer of the complaint, the petitioner appealed to the Supreme Court of the Philippines and

that court, after hearing, affirmed, on November 28, 1921, the judgment thus appealed from.

The stipulated facts are these:

> "That the plaintiff is a corporation sole, constituted under sections 154 to 164 of Act No. 1459 of the Philippine Commission, and is organized and operated for religious, beneficial, scientific and educational purposes in these Islands and in its Missions in China, Cochinchina and Japan, and that neither its net income nor part of its rents from whatever source it may come is applied to the benefit of any particular stockholder or individual, or of any of its members, and that no part of the whole or of some of its temporal properties belong to any of its members, who have no rights to the same, even in case of dissolution of the corporation.
>
> "That the dividends and interests or profits and expenses which appear in Exhibit 1 of the defendant as the income of the plaintiff, constitute the income derived from the investments of the capital of the plaintiff corporation, which was invested, in the year 1913, nearly in the manner and form specified in Exhibit 2 of the defendant, and that the rents appearing in Exhibit 1 were derived from the properties which together with their valuations appear in Exhibit 3 of the defendant." (From decision of the Insular Supreme Court, record pp. 13–16.)

The Insular Supreme Court found the following additional facts:

> "According to Exhibits 1, 2 and 3, above mentioned, the plaintiff received 90,092.70 for rents on lands and buildings situated in Manila, Cavite, and Rizal; 96,465.54 as dividends on shares of stock in the Bank of the Philippine Islands, *Fábrica de Hielo de Manila,* Johnson Pickett Rope Company, Germinal Cigar and Cigarette Factory, and Philippine Sugar Development Company; the sum of 54,239.19 as interests on money loaned and funds deposited in banks; and the sum of 68,144.45 as profits from sales

of 12 Germinal Cigar and Cigarette Factory stocks, wines, chocolate, merchandise, religious articles and unclassified profits and donations. After expenditures had been deducted from these earnings, the defendant found the sum of 154,130.68 on which, according to the contention of the defendant, income tax should be imposed at the rate of 1 per cent under the provisions of the Federal Income Tax Law of 1913." R. 14.

According to Exhibit No. 1 (record pp. 10–11), which is the respondent's income tax return for the calendar year 1913, respondent's total income amounted to 241,298.92 pesos and its expenditures to 169,305.24 pesos. The 169,-305.24 pesos is made up of expenses of the Provincial Father, subscription to newspapers, drafts remitted to Spain for subsistence of priests residing there, subsistence of priests of the corporation residing in Manila, interest paid on loans, interest on insurance fund, interest paid to banks, losses sustained on sale of hotel stock, on investment in a box manufacturing company, on investment in a drug store, depreciation on houses for rent, etc.

According to Exhibit No. 2 (record, p. 11), the respondent's capital of 380,041.76 pesos was invested in 1913 in the following institutions: The Bank of the Philippines, Manila Ice Plant, a hotel, a drug store, a box manufacturing company, a rope manufacturing company, a cigar factory and an insurance company. And according to Exhibit 3 (record p. 11), the respondent's real estate was valued in that year at 3,276,213.00 pesos, consisting of houses, agricultural estates and convent and church, the convent and church being valued at 1,888,353.00 pesos.

The Acts of October 3, 1913 (38 Stat. 114), of September 8, 1916 (39 Stat. 756), of October 3, 1917 (40 Stat. 300), and of February 24, 1919 (40 Stat. 1057), will be hereinafter referred to as the law of 1913, 1916, 1917, and 1918, respectively.

Section 24 of the law of 1916 repealed section 11 of the law of 1913, providing for income tax, except that "it shall remain in force for the assessment and collection of all taxes which have accrued thereunder." The law of 1913 was extended to the Philippines (38 Stat. 180, Par. M.).

The laws of 1916 (39 Stat. 756, *supra*), and 1917 (40 Stat. 300, *supra*), were repealed by the law of 1918 (40 Stat. 1057, *supra*), except for the assessment and collection of all taxes which accrued thereunder. The law of 1918 does not apply to the Philippines, and the citizens thereof, who are not residents of the United States, are taxable only on income derived from sources within the United States. A local income tax, however, is provided for the Philippines by making the law of 1916, as amended, apply to them (Holmes, Fed. Taxes, 1920 Ed., p. 9). Paragraph 2 of section 261 of the law of 1918 (40 Stat. 1087), empowers the Philippine Legislature to amend, alter, modify, or repeal the federal income tax statutes in force in the Islands.

The pertinent provisions in the law of 1913 (38 Stat. 114, *supra*), 1916 (39 Stat. 756, *supra*), and 1917 (40 Stat. 300, *supra*), relating to exemptions, are as follows:

Par. G. (a) of 1913 (38 Stat. 172),—

> "*Provided, however,* That nothing in this section shall apply * * *, nor to any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual, * * *."

Section 11, No. 6, of 1916 (39 Stat. 766),—

> "That there shall not be taxed under this title any income received by any—
> * * * * * * *
> "Sixth. Corporation or association organized and operated exclusively for religious, charitable, scien-

tific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual."

Section 201 of 1917 (40 Stat. 303),

"This title shall apply to all trades or businesses of whatever description, whether continuously carried on or not, except—

* * * * * * *

"(b) Corporations exempt from tax under the provisions of section eleven of Title I of such Act of September eight, nineteen hundred and sixteen, as amended by this Act, and partnerships and individuals carrying on or doing the same business, or coming within the same description; * * *."

## ASSIGNMENT OF ERRORS.

I.

The Supreme Court of the Philippine Islands erred—

(a) In holding that the respondent corporation was organized and was operated *exclusively* for religious, charitable, scientific, or educational purposes; and

(b) In not holding that the respondent corporation was engaged from March 31, 1913, to December 31, 1913, in such ordinary commercial transactions as took it out of the provisions of the above mentioned paragraph 'G (a)" of the Act of October 3, 1913, *supra*.

## ARGUMENT.

*The respondent corporation was not organized and operated exclusively for religious, charitable, scientific, or educational purposes during the year 1913.*

In order to come within the provisions of par. G (a) of the law of 1913, *supra,* the respondent must meet three tests: "(a) It must be organized and operated for one or more of the specified purposes; (b) it must be organized and operated exclusively for such purposes; and (c) no part of

its income must inure to the benefit of private stockholders or individuals." Holmes Fed. Taxes, 1920 Ed. p. 214.

While we do not urge that the respondent did not meet the first and third of these tests, we do insist that it did not meet the second because it was not organized and operated *exclusively* for religious, charitable, scientific, or educational purposes.

Exhibit No. 1 on page 10 of the record shows that the entire net income upon which the tax in question was levied was derived from purely secular properties, with the possible exception of some 6,800 pesos derived from "sales of religious articles" and given as donations for mass, and that these secular properties were so used for the *sole* purpose of obtaining *revenue* or *profit*, which revenue or profit was intended to be used, and actually was used, in furtherance of the purposes for which the respondent was organized and incorporated. Furthermore, the various transactions, out of which that income arose, were purely industrial and commercial in nature, kind and character.

The line must be drawn somewhere. The inquiry therefore arises as to what is the test by which we are to determine whether or not a particular association or corporation is or was organized and operated exclusively for one or more of the specified purposes. Is it the dominant purpose in the use of the property or in the performance of the transactions? Or, is it the expenditure of the income or profits for the purposes for which the particular institution was organized or incorporated? We say the former, regardless of how or for what purpose the revenue or profits are expended or are to be expended. The respondent says the latter, provided only that the revenue or profits are obtained by the particular association or corporation from the use of its own property or by its own transactions. In pursuing this inquiry, we do not desire to be understood as in-

sisting that a corporation, such as the respondent, must be supported wholly from donations in order to be entitled to the exemption. Where property acquired by an association or a corporation is only such as is reasonably necessary for religious, charitable, scientific, or educational purposes, it is desirable that it be rendered productive, so far as this does not interfere with its religious, charitable, scientific, or educational work. Again, where property is acquired primarily for one or more of these specified purposes, and is put only incidentally to a business use, it may well be that such use does not call for a ruling that the association or corporation is not operated exclusively for such purpose or purposes.

Under the law of 1913, par. G (a), *supra,* no income received by any corporation "organized and operated *exclusively* for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual," could be taxed. The requirement that income shall not inure to the benefit of private individuals is distinct from and in addition to the requirement that the corporation shall be organized and operated exclusively for one or more of the purposes stated. Or, in other words, the statute contemplated that there may be cases in which there is no private profit to individuals and yet the operations of the corporation are not exclusively religious, charitable, scientific, or educational, as the case may be. An ordinary industrial or commercial corporation which gives all of its net income to religious, charitable, scientific, or educational purposes would not thereby fall within the provisions of par. G (a), *supra.* The question whether a corporation which carries on those activities as well as industrial and commercial activities at the same time is operated *"exclusively"* for religious, charitable, scientific, or educational purposes, because it chooses to spend the

money which it earns in business in its religious, charitable, scientific, or educational work, must be determined by the intent of Congress in enacting par. G (a), *supra*.

While the general rule applicable to the enacting clause is that a revenue law should be construed strictly in favor of the taxpayer, it is well settled that a claim of exemption from taxation must be clearly made out. *Commercial Health & Accident Co.* v. *Pickering,* 281 Fed. Rep. 539, and cases cited therein. Paragraph G (a), *supra*, being an exemption statute, is in the nature of a proviso following an enacting clause general in its language and objects, and the rule announced in *United States* v. *Dickson,* 15 Pet. 141, to the effect that such a proviso is construed strictly and takes no case out of the enacting clause which does not fall fairly within its terms, applies here.

The character of the respondent as a corporation sole must be determined from its charter or the law under which it was incorporated. It was stipulated that the respondent is a corporation sole constituted under sections 154 to 164 of Act No. 1459 of the Philippine Commission (5 Pub. Laws 224). An examination of these sections will show that only sections 154 to 159, inclusive, are applicable to the respondent. The other sections do not relate to corporations sole. Sections 154 to 164, inclusive, are entitled "Religious Corporation." Under section 154, the respondent became a corporation sole for the administration of its temporalities and the management of its estates and properties. Under section 157, all such temporalities, estates and properties are held in trust for the use, purpose, and sole benefit of the Order or Church, "including hospitals, schools, colleges, orphan asylums, parsonages, and cemeteries thereof." Section 159 provides that "Any corporation sole may purchase and hold real estate and personal property for its church, charitable, benevolent, or educational purposes,

and may receive bequests or gifts for such purposes." Upon obtaining authority from the proper court, a corporation sole may also mortgage or sell real property held by it.

Under the special language of paragraph G (a), *supra*, the question does not depend upon whether the respondent is a "religious" corporation or even whether its industrial and commercial activities can be justified as within its chartered powers. There is, however, substantial doubt whether the legislative body intended to permit "religious corporations" to engage in such activities as those in which the respondent was engaged. We here use the terms "industrial and commercial activities" in their broad general sense and not in their restricted sense as they may be used in the Civil and Commercial Codes of the Philippine Islands. It has been said of a statute permitting a religious corporation to hold "real and personal property for purposes appropriate to its creation" that "To be thus appropriate it is not enough that the property sustain a slight or remote connection with the purposes contemplated. The mere fact that money may be necessary to meet expenses will not authorize the corporation to engage in some industrial enterprise to earn it." *State* v. *Amana Society*, 109 N. W. (Ia.) 894. In *First Methodist Episcopal Church* v. *Dixon*, 178 Ill. 260, 52 N. E. 887, a religious corporation sought to tear down an old building on its property and erect a modern business building, using the income derived therefrom for its religious purposes; and it was held that this was not authorized by a statute permitting its members to hold ten acres of land, and to "build thereon such houses and buildings as they may deem necessary for the purposes aforesaid."

Counsel for respondent cites in his brief filed in opposition to the petition for the writ certain cases which he contends support the proposition that the respondent's character as a religious, charitable, scientific, and educational institu-

tion was neither impaired nor destroyed by making its capital and properties produce income as shown by the record. In the principal case relied upon, *Book Agents of Methodist Episcopal Church, South* v. *Hinton,* 92 Tenn. 188, 19 L. R. A., 289, 21 S. W. 321, the volume of business done by the publishing house during the year in question was $336,800, of which about $6,000 was derived from what, in the agreed statement of facts, was called "secular work." The court concluded as follows:

> "We are of opinion that the plaintiff is an institution created for both religious and charitable purposes, that the ultimate use of its property has been in accordance with these purposes, that the income and profit derived from the use of its property have been exclusively applied to religious and charitable purposes, and hence it is entitled to exemption, under the provisions of the Constitution and Act."

This case goes no farther than to hold that a mere occasional or incidental or subsidiary use of the property for some secular object will not remove the exemption under the Tennessee Constitution and statute. In *Congregation of United Brethren of Salem and Vicinity* v. *Board of Com'rs. of Forsythe County,* 115 North Carolina 489, reported in 20 S. E. 626, the property sought to be exempted consisted of credits and notes. The statute exempted from taxation "property belonging to and set apart and exclusively used for the university, * * *." The interest on the credits and notes was applied exclusively and faithfully to educational, religious, and charitable purposes. "It seems to us," says the court, "that the corpus of the fund is 'set apart and used exclusively' for such purposes."

The judgments of the court in the cases of the *City of New Orleans* v. *Poydras Orphan Asylum,* 9 La. Ann. 584, *City of New Orleans* v. *Poydras Orphan Asylum,* 33 La Ann. 850, and *New Orleans Female Orphan Asylum* v. *J. D.*

*Houston,* 37 La. Ann. 68, rest upon the construction given the particular statutes therein involved, which are quite different from par. G. (a), *supra.* The same may be said of the case of *State* v. *Silverthorn,* 19 Atl. (N. J.) 124. Clearly therefore, these cases are not in point.

Although no State constitutional or legislative enactment is involved in the instant case, and although the decisions of the State courts are not binding upon this court, save only so far as they are founded on sound principles of construction applicable to all legislative enactments, nevertheless the exemption statutes of some of the States, being quite similar to par. G (a), *supra,* a consideration of what has been adjudged in those States may furnish some aid in determining whether or not our contention is sound.

In *Congregational Sunday School and Publishing Society* v. *Board of Review,* 290 Ill. 108, 125 N. E. 7, the plaintiff published and sold religious books at a profit. It also furnished such books free to needy Sunday schools. Its business showed a profit for several years. No stock was issued, no dividends are declared, and no profits accrued to any individual. On this state of facts, the assessor sought to tax the property used in the publishing business, under a statute (Hurd's Rev. St. 1917, C. 120) which provides that "All property used exclusively for religious purposes, * * *," and "all property of institutions of public charity, * * *, when such property is actually and exclusively used for such charitable or beneficent purposes, * * *," shall be exempt from taxation. The Supreme Court of the State, in setting aside a decision of the Board of Review upholding such tax, said: "It is not the use to be made of the profits but the nature of the business done that is to be considered in deciding the question of liability to taxation." In other words, the Court declared that neither profit-making nor the character of the causes to which the profits of a charity are

applied is the test by which exemption from taxation is determined, *but whether the business which the charity engages in is itself a charity.* The point is not whether the charity makes a profit or does not make a profit, but whether the purpose of the particular business out of which a profit is sought is itself charitable.

There are many decisions which hold that a charity is properly taxed on property used strictly for commercial purposes and that it is no ground for exemption that the profits of the business are applied to charitable purposes. *Stahl* v. *Kansas Educational Ass'n.*, 54 Kan. 542, 38 Pac. 796; *City of New Orleans* v. *St. Patrick's Hall Ass'n.*, 28 La. Ann. 512; *Ridgely Lodge* v. *Redus*, 78 Miss. 352, 29 So. 163; *Parker* v. *Quinn*, 23 Utah 332, 64 Pac. 961; *Trustees Academy of Richmond County* v. *Bohler*, 80 Ga. 159, 7 S. E., 633; *Young Men's Christian Ass'n.* v. *Douglas County*, 60 Neb. 642, 83 N. W. 924.

In *First Methodist Church* v. *City of Chicago*, 26 Ill. 482, the plaintiff owned valuable property in the city. The third floor was used for church purposes and the other floors were rented for commercial purposes. The rental was applied altogether to the purposes of religion; yet the court held that the part of the building used for profit should be taxed. In *American Sunday School Union* v. *City of Philadelphia*, 161 Pa. 307, 29 Atl. 26, the court said:

> "Conceding the fact that the society is an 'institution of purely public charity,' and as such exempt from taxation, it seems to us, such an institution may, as an aid to the accomplishment of its primary object, carry on a business, or use part of its property for a business purpose which renders such business or such part of its property taxable. * * * That the entire profits of this branch of the business are devoted to the purposes of the charity no more changes its business nature than if, instead of a book store,

the society had established and carried on a shoe store."

In *Sisters of Peace* v. *Westervelt,* 64 N. J. Law 510, 45 Atl. 788, the court held that:

> "The fact that the profits of a commercial enterprise are either in whole or in part devoted to charity certainly does not operate to render the business itself a charity, nor is the property in which it is carried on, by reason of such appropriations of profits, used for charitable purposes."

In *Commonwealth* v. *Lynchburg,* 115 Va. 745, 80 S. E. 589, a Young Men's Christian Association was held to be exempt from taxation, regardless of the fact that it charged for billiards, for bowling, for rooms, and for annual dues, the court saying:

> "If the dominant purpose in use made of these rooms is to obtain revenue or profit, although it is to be applied to the general objects of the association, it would render the property liable to taxation. But if the use made of those rooms has direct reference to the purposes for which the association was incorporated, and tends immediately and directly to promote those purposes, then its use is within the provisions exempting the property from taxation, although revenue or profit is derived therefrom as incident to such use. * * * Manifestly, a member of the association who was a lodger or inmate of the building would be in a better situation to take advantage of the privileges offered by the association, and more likely to take advantage of them, other things being equal, than a member who lodged elsewhere."

In *People* v. *University,* 80 Ill. 333, the Supreme Court of the State said:

> "By the language of the constitution we have quoted, while a discretion is conferred on the Gen-

eral Assembly, whether to exempt or not, and if it shall determine to exempt, the amount of the exemption, it is clearly restricted, in the exercise of this discretion, to property for schools, and for religious and charitable purposes. Property for such purposes, in the primary and ordinary acceptation of the term, is property which is itself adapted to and intended to be used as an instrumentality in aid of such purposes. It is the direct or immediate use, and not the remote or consequential benefit to be derived through the means of the property, that is contemplated."

This court, although differing with the State court as to the nature and extent of the constitutional limitation, used the following significant language:

> "The first observation we have to make is that the Constitution does not say 'property used for schools,' as the opinion of the court implies. Neither the important word *use* or *schools* is found in the section of the instrument on that subject. If the language were that the legislature might 'exempt property for the use of schools,' we should readily agree with that court. Indeed, that would be the appropriate language to convey the idea on which the court rests its decision." *University* v. *People*, 99 U. S. 309.

The result is that the State courts are practically unanimous in holding that where the primary or dominant purpose in the use made of the property is the making of profits and the secondary purpose is the devoting of these profits to religious, charitable, scientific, or educational purposes a claim for exemption from taxation can not be sustained.

We think it ought to be conceded that if it be true that the entire profits derived by the respondent from the various sources stated in Exhibit No. 1 were devoted to the purposes of the Order, that fact would no more change the *nature* of its *business* than if such profits had been dis-

tributed among the members for investment in any private enterprise. The renting and leasing of the houses and large estates, the buying and selling of stocks of corporations and associations and the buying and selling of wines, etc., would still be commercial transactions pure and simple. It is no answer to this proposition to say that if the respondent is not permitted to invest its capital and profits in income producing enterprises, it would soon have to cease its activities for lack of funds, for all agree that the tax is levied upon the *net* income only and not upon the gross income or market value of the properties.

## ADMINISTRATIVE RULINGS.

Article 517 of the United States Treasury Department Regulations 45 (1920 Edition) and 62 (1922 Edition), relating to income and excess profits taxes under the Revenue Acts of 1918 (40 Stat. 1057) and 1921 (42 Stat. 227), respectively, (the exemption language of which is very similar to that contained in the law of 1913 (par. G (a), *supra*), provides in part as follows:

> "Where a religious corporation owns a large quantity of farm land and works it, and also manufactures and sells clothing and other articles for profit, it is not operated exclusively for religious purposes and is not exempt, even though its property is held in common and its profits do not inure to the benefit of individual members of the society."

The Bureau of Internal Revenue, U. S. Treasury Department, in Office Decision No. 953 (Cumulative Bulletin No. 4, January-June, 1921, Income Tax Rulings, page 261) laid down this general rule:

> "An organization which would otherwise be exempt from taxation but which operates in a non-exempt manner is not entitled to exemption under the provisions of section 231 of the Revenue Act of 1918; and furthermore an organization which is

ordinarily exempt but which owns property in excess of its needs and carries on industrial pursuits distinct from its exempt activities is not exempt from taxation."

In Solicitor's Memorandum No. 952 (Cumulative Bulletin December, 1919, page 207) it was said that where a fruit growers' association claiming exemption under Section 231 (11) of the Revenue Act of 1918 "departs from this purpose and engages in an ordinary business pursuit—such as the buying and selling of fruit—it is thereby removed from the exempt class."

Paragraph 3, section 231 of the law of 1918, reads as follows:

> "Fraternal beneficiary societies, orders, or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and (b) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents."

In Office Decision No. 508, U. S. Bureau of Internal Revenue (Cumulative Bulletin No. 2, January-June, 1920, Income Tax Rulings, page 207), it was said:

> "The M Association is an incorporated society operating under the lodge system throughout the United States, its charter providing for the union of eligible members into a grand fraternal beneficiary, educational and patriotic society. Assessments are levied upon its members to provide for the payment of sick and death benefits, for disability relief in case of accident and for promoting their social, moral, educational and patriotic advancement. It also derives income from subscriptions to a daily and a weekly newspaper which it publishes as well as from job printing and other sources. None of the income inures to the benefit of any private stockholder or individual.

"Held, that although this society has fraternal and benevolent features it is chiefly a patriotic organization interested in the general welfare of its members and that its powers are so extensive as to preclude its classification under paragraph 3, section 231 of the Revenue Act of 1918.

"While it is possible that some branch of the organization comes within the provisions of the Act, the society as a whole is not an exempt organization and must, therefore, file returns of annual net income and pay any taxes thereby shown to be due."

Paragraph 12, section 231 of the law of 1918, reads:

"Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title."

In Office Decision No. 60, U. S. Bureau of Internal Revenue (Cumulative Bulletin, December, 1919, Income Tax Rulings, page 193), it was held that:

"A railroad company, which turns all of its income over to a charitable institution as a dividend does not come within the provision of section 231 (12), as it is actively engaged in the operation of a railroad system."

The practical construction of a statute by those charged with carrying it into effect is entitled to great weight when the statute afterwards comes before the court for construction. In *Schell's Executors* v. *Fauché,* 138 U. S. 562, 572, it was said:

"In all cases of ambiguity, the contemporaneous construction, not only of the courts but of the departments, and even of the officials whose duty it is to carry the law into effect, is universally held to be controlling."

In *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 349, the court said:

> "It is settled by many recent decisions of this court that a regulation by a department of government, addressed to and reasonably adapted to the enforcement of an act of Congress, the administration of which is confided to such department, has the force and effect of law if it be not in conflict with express statutory provision. *United States* v. *Grimaud,* 220 U. S. 506; *United States* v. *Birdsall,* 233 U. S. 223, 231; *United States* v. *Smull,* 236 U. S. 405, 409, 411; *United States* v. *Morehead,* 243, U. S. 607."

*The Government of the Philippine Islands* v. *El Monte De Piedad Y Caja De Ahorros De Manila,* 35 Phil. Reps. 42, was an action to recover internal revenue taxes assessed on the monthly deposits and the capital employed by the defendant from the first of August, 1904, to June 30, 1914. The defendant is an institution organized in accordance with the canon law, having been created by the royal order of the King of Spain of July 8, 1880, made under the royal patronate powers then existing in the Crown of Spain. That royal order brought into existence an institution for the safe investment of the savings of the poor classes and to assist the needy, in time of need, by loaning such savings to them at a low rate of interest. The theory upon which the tax was assessed was that the defendant was a bank within the definition of Section 110 of Act No. 1189, known as the Internal Revenue Law. The exemption was sought on the ground that the defendant was a savings bank. The court found and held that the defendant was a profit-making institution, although it may not have been designed as such, and that the profits derived from the investments and the deposits belong to the institution itself.

Hence, on both principle and authority, we insist that, so far as this tax is concerned, the respondent stands upon the

same footing as any individual, partnership, or corporation whose business it is to rent and lease real estate and to buy and sell stock, shares and merchandise. In this connection, we desire to repeat that we are not now concerned with the technical meaning of industrial and commercial associations and corporations as they are defined in the Civil and Commercial Codes of the Philippine Islands.

Under section 27 of the Act of August 29, 1916 (39 Stat. 545), this court has jurisdiction to review on certiorari (section 5 of the Act of Sept. 6, 1916; 39 Stat. 726) the judgment drawn in question in the case at bar because par. G (a) of the Act of October 3, 1913, *supra*, is really and substantially involved, for the construction placed upon that paragraph by the Insular Supreme Court defeats the right of the Philippine Government to collect and retain the tax, whereas an opposite construction will sustain that right.

## CONCLUSION.

We, therefore, respectfully submit that the judgment under review should be reversed, with cost.

GRANT T. TRENT,
*Lieutenant-Colonel, Judge Advocate.*
LOGAN N. ROCK,
*Captain, Judge Advocate.*
*Attorneys for Petitioner.*

Of Counsel,
NELSON T. HARTSON,
*Solicitor, Internal Revenue.*
F. GRANVILLE MUNSON,
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Sagrada Orden de Predicadores de la Provincia del Santísimo Rosario de Filipinas, *Respondent*.

# Respondent's Brief on the Merits

GABRIEL LA O,
Counsel for the Respondent.

ALFREDO CHICOTE,
JOSE ARNAIZ,
Attorneys for the Defendant
Respondent herein.

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# In the Supreme Court of the United States

**October Term. 1921.**

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**No. 425.**

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vs.

**Sagrada Orden de Predicadores de la Provincia del Santísimo Rosario de Filipinas,** *Respondent.*

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# Respondent's Brief on the Merits

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For the sake of brevity and not to incur repetition and admiting the statement of the case made in petitioner's brief to be clear and correct, we submit this case before this Honorable Supreme Court under the statement of facts set down by the petitioner and accordingly we proceed to answer its argument:

The two grounds of errors established by the petitioner as commited by the Supreme Court of the Philippine Islands, are:

> (a) In holding that the respondent corporation was organized and was operated exclusively for religious, charitable, scientific, or educational purposes; and

(b) In not holding that the respondent corporation was engaged from March 31, 1913, to December 31, 1913, in such ordinary commercial transactions as took it out of the provisions of the above mentioned paragraph "G (a)" of the Act of October 3, 1913.

These grounds are set forth in two separate paragraph as constituting two separte errors but, practically, they are only one, since, if it is held that the respondent corporation was operated exclusively for religious, charitable, scientific or educational purposes, then, it is clear, that it was not operated for other purposes, such as commercial enterprises.

The decision of the Supreme Court of the Phil. Islands was written by Mr. Justice J. Johnson and concurred in by the Chief Justice of said court and four of its Associated Justices, without having been recorded any dissenting opinion. All and every one of the members of the Supreme Court **a quo** are fully aware of the conditions prevailing in these Islands and the benefits that the religious corporations have brought to the inhabitans thereof. This is specialy so in the case of respondent herein by reason of its being the oldest of such religious corporations.

The respondent in this case is a Corporation whose original members arrived in these Islands in the 16th century. It founded the still existent Santo Tomas University in Manila, Philippine Islands, in the year 1622; founded the College known by the name of "San Juan de Letran" in 1640 which stands on the site formerly occupied by an Orphan Asylum and is one of the oldest institutions of learning in the Islands. During its long existence it has also

founded and is still supporting several other colleges and many other religious, charitable and educational organizations aside from various missions for the dissemination of Christianity located in China and adjacent countries. During the many years that have elapsed since it came to exist the respondent has accumulated real and personal properties. The chief and sole purposes of its constitution being to propagate the Catholic religion among the inhabitants of these Islands, establish means for the education, assistance and support of orphan children, and other kindred purposes, the corporation received certain real estate, rural and urban, through royal concessions, gifts, bequests, devises, etc., and decided to lease such land, and that is the origin of the income now referred to in the petitioner's Exhibits 1 and 2, not for commercial profit as alleged by petitioner.

The above mentioned facts are of public knowledge and the members of the Supreme Court of the Philippine Islands being fully cognizant thereof did not hesitate in affirming the judgment rendered by the lower court in whose decision is quoted the following paragraph:

> "Having in mind the very ancient existence of said religious corporation, and taking into consideration its nature and purposes which cannot be compared with agricultural, mercantile, industrial and other kind of corporation, and taking into consideration its nature and purposes which cannot be compared with agricultural, mercantile, industrial and other kinds of corporations, and considering the great number of its members who must have a decent support, if the property—which is

not unlimited—belonging to the religious corporation, the herein plaintiff, were not to be invested in the most productive manner, it would soon be exhausted, and, as a consequence thereof, the ends to which it was established may come to naught, to the prejudice of that part of humanity which is benefited thereby."

## ARGUMENTS

### In answer to those of the Petitioner

The petitioner contends that in order to be exempt the respondent corporation must meet three tests: (a) it must be organized and operated for one or more of the specified purposes; (b) it must be organized and operated exclusively for such purposes; and (c) no part of its income must inure to the benefit of private stockholders or individuals.

The petitioner admits that the respondent meets the two tests (a) and (c), but does not admit that it also meets the test(b). We do not see any practical difference between the test (a) and (b) because admiting, as the petitioner does, the test (a), logically it must admit the test (b), there being no matterial difference between them. If the respondent is organized and operated for some specified purpose, it must also be admitted that it is organized and operated for such purpose. The Supreme Court of these Islands in deciding this particular point said:

> "It is not contended that any part of the profits derived by the plaintiff from the secular investment above referred to was devoted to, or used for, any other purpose than the carrying out of its religious and educational work. It is admitted, on the other hand, that

no part thereof inured to any individual member of the plaintiff corporation. Neither is it even intimated by the apellant that the funds so invested by the appellee, as above indicated, were, at the time of their investment, needed by the plantiff in order to carry out its religious or educational work. On the contrary, appellant himself says in his brief that "all these (funds) were in excess of the corporation's legitimate religious needs."

We must keep in mind that the respondent corporation was organized in accordance with the provisions of Act 1459 of the Philippine Commsion.

This Act in the part thereof entitled **"Religious Corporations"** defines the powers and purposes of such corporations and, in sections 154, 157 and 159 provides:

Sec. 154. For the administration of the temporalities of any religious denomination, society, or church, and the management of the estates and properties thereof, it shall be lawful for the bishop, chief priest, or presiding elder of any such religious denomination, society or church to become a corporation sole unless inconsistent with the rules, regulations, or discipline of his religious denomination, society, or church, or forbidden by competent authority thereof.

Sec. 157. From and after the filing with the Chief of the Divisions of Archives, Patents, Copyrights, and Trade-Marks, of the Executive Bureau of the said articles of incorporation, verified by affidavit or affirmation as aforesaid and accompanied by the copy of the commission, certificate of election, or letters of appointment of the bishop, chief

priest, or presiding elder, duly certified as prescribed in the section immediately preceding, such bishop, chief priest, or presiding elder, as the case may be, shall become a corporation sole, and all temporalities, estates, and properties of the religious denomination, society, or church therefor, administered or managed by him as a corporation sole, for the use, purpose, behoof, and sole benefit of his religious denomination, society, or church, including hospitals, schools, colleges, orphan asylums, parsonages and cemeteries thereof.

Sec. 159. Any corporation sole may purchase and hold real estate and personal property for its church, charitable, benevolent, or educational purposes, and may receive bequests or gifts for such purposes.

The objection of the petitioner that the respondent corporation does not meet the test (b) is that it engages in commercial activities, but it must be noted that Act 1459 authorizes this kind of corporation to lease or rent any or all of its real estate, to invest and reinvest its income and capital in such commercial institutions or enterprise as its manager may see fit, and finally, to purchase and hold real and personal property for the corporation, all for its final use in its religious and educational purposes.

The Act of Congress of October 3, 1913, the provisions of which were extended to the Philippine Islands by paragraph M, of said Act, is the only revenue law involved in this case, and neither that of 1916 nor that of 1917 are applicable hereto since the amount paid was simply for the income tax of 1913.

Paragraph A, Subdivision 1 of section "ii" provides:

"That there shall be levied, assessed, collected and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of one per centum, per annum upon such income, except as hereinafter provided; and a like tax shall be assessed, levied, collected and paid annually upon the entire net income from all property owned and of every business, trade, or profession carried on in the United States by persons residing elsewhere."

Paragraph B, subdivision 2, prescribes in part as follows:

"Subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property whether real or personal, growing out of the ownership or use of, or interest in real or personal property, also from interest, rent, dividends, securities or the transaction of any lawful business carried on for gain or profit or gains or profits and income derived from any source whatever including the income from, but not the value of, property acquired by gift, bequest, devise, or descent: PROVIDED, ....."

Paragraph G (a) provides in part, as follows:

"The normal tax hereinbefore imposed

upon individuals likewise shall be levied, assessed, and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation, jointstock, company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships; but if organized, authorized, or existing under the laws of any foreign country, then upon the amount of net income accruing from business transacted and capital invested within the United States during such year: PROVIDED, HOWEVER, That nothing in this section shall apply to labor, agricultural, or horticultural organizations, or to mutual savings banks not having a capital stock represented by shares, or to fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system..... nor to any corporation or association organized and operated exclusively for religious, charitable, scientific, or educationl purposes, no part of the net income of which inures to the benefit of any private stockholder or individual...."

The petitioner contents (pag. 7) that:

**"The question whether a corporation which carries on those activities as well as industrial and commercial activities at the same time is operated "exclusively" for religious, charitable, scientific, or educational purposes, because it chooses to spend the money which it earns in business in its religious, charitable, scientific, or educational work, must be determined by the intent of Congress in enacting par.**

G (a), supra."

We agree in that opinion and accordingly we do contend that said Act of Congress, just above cited, when it refers to this Corporations does not do so under the hypothesis that they possess nothing or that they derive nothing from their properties, for said Act says, in its paragraph G. **"The normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed..... to any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.....** and that normal tax is no other than that provided in paragraph A, sub-section 11, and in paragraph B, sub-section 2, which contain the following clear and specific provision:

> "Subject only to such exemrtions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, business, trade, commerce, or sales, or dealings in property, whether real or personal growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities or the transaction of any lawful business carried on for gain or profit, or gains, or profits, and income derived from any source whatever."

Therefore that Act and that tax refer to, and this latter is levied upon, profits and earnings of all

kinds, from all sources, and the Act, in making reference to those profits and earnings in respect to certain organizations, associations and corporations, among others, those organized and that operate exclusively for religious, benevolent, scientific and educational purposes, declares that these are exempt from this tax, provided that no part whatever of their net income inures to the benefit of any private stockholder or individual.

As will be seen by this Honorable Supreme Court, we have copied the exact terms of the Act to avoid erroneous interpretations and to prove that, abiding by the law exactly as it stands, the respondent is entitled to the exemption that lies in its favor.

Further on the petitioner says that the character of the respondent as a corporation sole must be determined from its charter or the Law under which it was incorporated. We say that its character cannot be a matter of discussion now because Exhibit A of the plaintiff, the respondent herein, admitted by the defendant, the petitioner herein, (pag. 9 Transc. of Rec.) as well as the stipulation of facts submitted by the parties for decision to the trial court, clearly established the character of the respondent. Said stipulation of facts reads as follow: (pag. 13-14 Transc. of Rec.)

> "That the plaintiff is a corporation sole, constituted under section 154 to 164 of Act No. 1459 of the Philippine Commission, and is organized and operated for religious, beneficent, scientific and educational purposes in these Islands and in its missions in China, Cochinchina and Japan, an that neither its net income nor part of its revenue from whatever

source derived are applied to the benefit of any particular stockholder or individual, or of any of its members, and that no part of the whole or of any of its temporal properties belong to any of its members, who have no rights to the same, even in case of dissolution of the corporation.

"That the dividens and interest or profits and expenses which appear in the defendant's Exhibit 1 as the plaintiff's income constitute the income derived from the investments of the capital of the plaintiff corporation, which was invested, in the year 1913, nearly in the manner and form specified in Exhibit 2 of the defendant, and that the rents appearing in Exhibit 1 were derived from the properties which, together with their valuations, are shown in the defendant's Exhibit 3."

Such being the facts there is no question and there can be no doubt that the respondent is entitled to the right of exemption from taxation, as it claims to be, and as has been recognized and conceded by both the trial court and the Supreme Court of the Philippine Isalnds i n accordance with and by virtue of paragraph G (a) of the Act of Congress of 1913.

The petitioner also says that there is subtantial doubt whether the Legislative Body intended to permit "religious corporation" to engage in such activities as those in which the respondent is engaged.

In deciding this particular point the Supreme Court of the Philippine Islands said in its judgment:

"It appears, then, that the plaintiff invested its surplus funds on hand in the secular enterprises above mentioned in order to derive profits therefrom, to be used exclusively in its

religious and educational work. The operation, therefore, though, of course, not religious or educational in nature, was made ultimately and exclusively for religious and educational purposes. We are therefore of the opinion that notwithstanding the investment of its surplus funds in the enterprises mentioned in defendant's Exhibits 2 and 3, the plaintiff corporation still continued to be "organized and operated exclusively for religious and educational purposes," and was, therefore, entitled to the exemption provided by law."

But the preceding conclusion is not in accordance with the petitioner's opinion who practically is of the idea that having invested part of its funds in stock of some commercial activities the corporation was not exclusively organized and operated for its religious and educational purposes. Nowhere in the record does it appear that the respondent corporation was ever engaged in any commercial activities for purposes of profits as the aim and object of the corporation.

True it is that in Exhibit 2 it does appear that, of its capital, about one ten per centum of the value of the real estate owned by the corporation was invested in shares of the Bank of the Philippine Islands, Manila Ice Plant, Metropole Hotel and other concerns of the kind, but that does not necessarily mean that the corporation was engaged in those business but merely signifies that that part of its capital was so invested. Neither does it mean that the object of the corporation was to invest its capital in shares of industrial enterprises, but simply shows that its surplus income was not idle, but invested in

such businesses as it could be in other activities and in loans. We do not see how it can be sustained that, for instance, a person who has acquired a number of shares of a cigar factory could be classed and recognized as a cigar manufacturer from the simple fact of his having become a stockholder in this kind of an industrial enterprise. Let us suppose, for example, that, instead of investing $5,180 in the Manila Box Manufacturing Co., $2,650 in Johnson Picket Rope Co. and other amount in other concerns up to $190,020.88 which, as appears from said Exhibit 2, is the sum total of the whole capital invested by the respondent in those commercial activities, and which, after all, is but an small amount compared with the total corporate capital, if, we repeat, instead of such investments, the respondent had kept that amount idle, the consecuences would have been that the companies benefitted by those amounts would have lost the direct help of the respondent's capital, and not only the respondent would have suffered loss but also the development of said companies would have been retarded and impaired and the Government itself would have suffered detriment, for we must bear in mind that the industrial or commercial concerns in which that small part of the petitioner's capital was invested have paid to the Government of the Philippine Islands the regular tax levied directly upon the profits and dividends of those companies or corporations and this is very particularly in point as regard the principal one, namely, the Bank of the Philippine Islands, in which, in 1913 the respondent had invested the sum of $138,237.04, according to the petitioner's Exhibit 2.

Furthermore in the statement Exhibit 1, it appears that among other sundry profits the respondent corporation had P2,711.15 from sales of wine. At first sight, and without any explanations of this item, anyone might think that the respondent was engaged in selling wine, chocolate or other merchandise, but such was not the case. It is a fact of which, undoubtedly, the members of this Honorable Court have personal knowledge, that the priests of catholic corporations such as is the respondent, are wont to use special wine in saying the daily mass. This particular wine is imported into the Islands, directly, by the respondent and is distributed among its members and the profits derived therefrom, as shown in Exhibit 1, represent the amounts obtained over and above its cost, and which are set aside for the payment of the general expenses and losses, that are charged to the account of the branches or entities constituted and organized for educational purposes, under the respondent's direction and protection, as well as to the priests pertaining to it and in charge of the parsonages distributed in different towns of the Islands.

Although we do not deem it necessary to go further into an examination of the different items of Exhibit 1, since this case is under consideration by this Honorable Supreme Court to determine the legality or illegality of the exaction of the tax collected as a whole, nevertheless we respectfully submit to your Honorable Body that if it were the respondent's object to engage in the selling of wine, chocolate, or other merchandise, it would necesarily appear that a part of its capital was invested in such enterprises, but the fact is, as shown in the petitioner's Ex-

hibit 2 that not one single cent was devoted to any such business.

We agree with petitioner in the statement that the State courts are practically unanimous in holding that where the primary or dominant purpose in the use made of the property is the making of profits and the secondary purpose is the devoting of these profits to religious, charitable, scientific, or educational purposes a claim for exemption from taxation can not be sustained, but:

**First,** the present case is not one where taxes upon real estate is concerned; and

**Second** even applying said doctrine to this case there is no proof in the record to warrant and justify the conclusion that the respondent corporation has ever had as its primary or dominant purposes, the making of profits from commercial activities, except for educational and religious purposes.

It does not appear from Exhibit 1 that all the income was derived from commercial sources, since income was had from **rents** ₱91,141.69, from **dividends** ₱93,918.04, from **interest** ₱54,239.19, and finally, from **sundry profits,** which according to the petitioner's opinion is ₱13,905.26 and subject to taxation.

The rent from **real estate** is in no wise income realized from any commercial source, unless it should appear that said rent is derived from transactions that consisted in leasing real estate to sublease it and obtain a profit resulting from the difference between the amount paid to the owner as rental and that received on the same account from the tenant. But that is not the case here. The petitioner was the owner of the premisses and as such was entitled to

collect its rentals without necessity of entering the field of commercial activites.

> "So an exemption of 'all charitable institutions' will exempt that leased out for business purposes the income from which is used for the purposes of charity (New Orelans v. Poydras Orphan Asylum, 33 La. Ann. 350; New Orleans Female Orphan Asylum v. Houseton, 37 La. Ann. 68).
>
> "And under a statute providing that the property of charitable institutions is hereby exempted from taxation, the property of an orphan asylum is exempt although it is leased to third persons in such a way as to produce an income which is devoted to the purposes of the charity (New Orleans v. Poydras Asylum, 9 La. Ann. 584)."

The income from **dividens** does come, it is true, from commercial activities, in the broad sense of the term, but it has no bearing in the present instance for the simple reason that the corporations that inure this income pay the income tax directly to the Government, in conformity with the provisions of the law.

Neither is the income from **interest** derived from any commercial source, when the person or entity obtaining said income is not one engaged in the loan business and has invested his or its surplus in that way so as not to have it idle.

> "If the endowment of religious societies is exempt, mortagages, the income from which is to be used to pay the minister's salary are exempt. (State v. Silverhorn, 52 N. J. L. 73)."

The income from **sundry profits** is virtually of no interest in the case at bar. As we have already said, the earnings or profits obtained from the sale of wines and other articles are practically nominal, since it represents the charges made against the individual accounts of the parsonages occupied by members of the corporation in the capacity of priests or of the missionaries, and against those of the colleges and other religious and charitable organizations conducted under the respondent corporation's guidance and assistance. Among this particular sundry profits it is to be noted that there is an item classed as **"Alms for mass, cash, (donations)"** in regard to which the petitioner has overlooked the provisions of law that exempt from taxation the income so obtained.

The respondent contended before the trial court and also the Supreme Court of the Philippine Islands and likewise contends hereby before this Honorable Court that, by making its capital and properties produce income as set forth in Exhibit 2, its character as a religious, charitable, scientific and educational institution is neither impaired nor destroyed, and this is undoubtedly true unless it should appear in the record that in the commercial enterprises in which it has a portion of its capital invested had ever taken an active and direct part. The mere circumstance of A being a stockholder does not mean that he is a merchant; the most that can be granted it that he is an owner.

The bare fact of Admiral Smith having loaned some of his savigns under security of a mortgage on

a real property does not mean that, besides being a naval officer, he is a money lender.

It would be a different proposition if A had bought a sufficient number of shares to control the business and in this way make himself the manager of the company. Or if Admiral Smith, having obtained his release from the Navy, had devoted all his savings and the money borrowed by him on credit to make loans to borrowers as a means of gaining an income. Then and under these circumstances A could properly be colled a businessman and Admiral Smith a money lender.

The petitioner, on page 15 of its Brief, says, that the renting and leasing of houses and large estates, the buying and selling of corporation stock, and the buying and selling of wines, etc., would still be commercial transactions, pure and simple.

We have something to say about this. As to the first part of the preceding averment, it must be made clear that the respondent is not, and never has been engaged in the renting and leasing of houses, convents or any kind of real estate. It has leased its own real estate, not the convents, but the houses not occupied by the members of the corporation. The farm lands or agricultural estate not being their development within the purposes of the corporation, precisely because it was not organized for agricultural pursuits were given out to tenants. There is some diference between one who leases his real estate and another who is engaged in the renting and leasing of real estate.

As to the second part of the petitioner's said averment, we have to say that the respondent is not

and never has been engaged in buying and selling of corporation stock. It does appear that some losses were suffered in the selling of the stock of the Metropole Hotel, Manila Box Manufacturing Co. and Philippine Drug Co., but these were suffered because those companies were liquidated and dissolved and what appears as lost in selling is the difference between the money paid for the shares when bought and the money recovered as their share in the liquidation. The fact that there is nothing in the income as profit made in the selling of stocks, except $125.40 from the sale of 12 shares of the GERMINAL, shows evidently that the respondent was not engaged in the buying and selling of corporation stocks.

In respect to the third part of the above-stated averment we have said enough in this Brief to dilucidate this point. Chocolate as well as the wine, religious articles, etc., are merely complementary means by which the corporation helps the priests of its community in charge of parsonages, and members of the different schools in the Islands conducted under its supervision.

In the message of the Governor General to the sixth Philippine Legislature (page 22-23) appeared the following statement:

> "In the commendable enthusiasm of the people for education, certain evils are likely to appear. When demand is great discrimination is often lacking. Partly due to the limited number of public schools, a large number of private schools are springing up, some of which manifest a tendency to commercialize education. .....
> ..... Furthermore, a rigid ex-

> amination by a government board before authority is given to practice a profession should be insisted upon and would be found to be the most effective method of eliminating schools of low standards or educational institutions organized purely for profit."

For the information of the Governor General and although such criticism could not be applied to the University of Sto. Tomás, one of the branches of education under the direction and support of the respondent's corporation, on account of the ancient charter and benefits already conferred on the community, there was submitted to the Governor General the following financial statement:

## SANTO TOMAS UNIVERSITY ANNUAL INCOME AND EXPENSES (1)

| FACULTY OF | General expenses | SALARIES | | Matriculated alumni. (2) | Cost of each alumni. | INCOME | |
|---|---|---|---|---|---|---|---|
| | | Profesors | Subaltern officers. | | | matriculation fees. | fees for Diplomas Titles, etc. |
| Law | ₱ 500.00 | ₱ 29,599.92 | | 95 | ₱ 256.00 | ₱ 8,402.00 | ₱ 280.00 |
| Medicine | 10,700.00 | 48,400.00 | | 403 | 42.70 | 38,412.00 | 6,400.00 |
| Pharmacy | 7,200.00 | 21,800.00 | | 47 | 572.54 | 3,752.00 | 1,260.00 |
| Philosphy & Learning | | 8,000.00 | | 9 | 1,113.49 | 170.00 | |
| Enginery | 3,205.86 | 16,600.00 | | 57 | 338.90 | 3,460.00 | |
| Theology | | 12,000.00 | | 7 | 2,131.63 | (3) | |
| Canonical Law | | 8,000.00 | | 2 | 5,145.71 | (3) | |
| General Office | | | ₱ 20,450.00 | | | | |
| TOTAL | ₱ 21,605.86 | ₱ 144,399.00 | ₱ 20,450.00 | 620 | | ₱ 54,196.00 | ₱ 7,940.00 |

TOTAL EXPENSES FOR INSTRUCTION ..... ₱186,455.78
" INCOME " " ..... " 62,136.00
DEFICIT ..... ₱124,319.78

(1) Exact data from the school year 1921—1922.
(2) Income from the respective faculty discounted.
(3) Instruction gratis for the alumni.

The preceding table shows for the school year 1921-1922 a deficit of ₱124,319.78, ammount that had to be covered from the general funds of the respondent's corporation. Practically the same financial status is a result of operation of the other colleges like **Colegio de San Juan de Letrán**, in Manila; **San Alberto Magno**, in Dagupan, Pangasinan, **San Jacinto** in Tuguegarao, Cagayan, **Santa Catalina** in Manila; **Santa Rita** in Santa Rita, Pampanga; **Santisimo Rosario** in Lingayen, Pangasinan, and others.

With said facts in view and such being the circumstances sorrounding the existence of the respondent, is there any ground to aver that the respondent is not organized exclusively for religious, benevolent, scientific and educational purposes, but for commercial purposes? The conclusion or result is that the respondent is a corporation entitled to the benefits of exemption established by the Act of Congress and the inversion given to its surplus from rents, donations, etc., is an incidental feature which can not be considered as the object for which the respondent was organized, as the petitioner contends.

The petitioner also argues that the tax is levied only upon the **net**, and **not** upon the gross income, and that therefore, our contention that if it be not permitted to invest its capital and profits in enterprises producing income, it would soon have to cease its activities for lack of funds, is not an answer to the petitioner's contention.

Exactly because the income tax is levied upon the net income, as provided in paragraphs A and B of the Act of Congress of October 3, 1913, and because paragraph G (a) declares the corporations of

the character of the respondent exempt from the payment of that tax, we maintain that the exaction made by the petitioner is illegal.

In the case of the United States vs. Kirby (7 Wall., 428) it was said by this Supreme Court that:

> "..... all laws should receive a sensible construction. General terms should be so limited in their application as not to lead to injustice, oppression, or an absurd consequence. It will always, therefore, be presumed, that the legislature intended EXCEPTIONS to its language which would avoid results of this character. The reason of the law should prevail in such case over the letter."

In the case of Hartranft vs. Weigmann (121 U. S., 609, 616), the Court said:

> "But, if the question were one of doubt, the doubt would be resolved in favor of the importer, as duties are never imposed upon the citizen upon vague or doubtful interpretations."

In the instant case, the language of the law is clear and definite, and the construction which the petitioner claims should be given to the ward "exclusively," quoted from the Act, would not only destroy the intent of the legislator, but also would involve a great juridical as well as grammatical error, because it confuses the term "ends" (purposes) with the term "means," considering them analogous in sense, while, as a matter of fact, they are completely different, convey entirely different ideas.

"Ends" are the object aimed at in an effort,

while "means" is that through which, or by the help of which, an **end** is attained.

If the petitioner himself admitted, as he did, in the stipulation of facts submitted to the trial court, that all the profits accrued to the respondent were applied to its religious, benevolent and educational ends, then what doubt, or even color of doubt, could there be that such profits or earnings are ought else than a MEANS for the realization of its, the respondent's corporative ENDS or purposes for which it was organized and for which it is operated and administered according to the provisions of the Law.

If the record should disclose, what does not, full and convincing proof that the legal transactions made for purposes of gain by the corporation, and that the collection of its earnings and other income was not necessary for the purposes of the corporation, that is, through the means of its maintenance to carry out its corporate ends, then and only then, we perhaps might be constrained to admit that such transactions, aimed at the acquirement of gain, might constitute a final purpose of the corporation, and not a lawful, reasonable, just, and adequate means for the sustainment of its corporate purposes, but with the knowledge (**vide** Stipulation of Facts) that such profits and earnings were and are applied toward the furtherance of religious, benevolent and educational purposes, how can those **means** for the realization of such well-defined designs be deemed to be corporative **ends?**

The respondent corporation was organized for the purpose or end of fostering, encouraging and maintaining religion, charity, science and education,

and, for the reason that its principal activities tend to enable the attainment of such praiseworthy goals, the State, throught mediation of law, relieves it of this burden, that is, does it the grace to remit this tax.

The legislator, in writing this exemption into the law, took into account only the purpose of the existence of the corporation, not else but the object or reason of its being, thus following the precedents which, as a general rule, have obtained in nearly all the states of the North American Union.

> "EXEMPTION OF CHARITABLE, BENEVOLENT, RELIGIOUS AND EDUCATIONAL INSTITUTIONS.—It is provided by statute in almost all of the statute in almost all of the states that the property of a charitable, benevolent, religious or educational institution, used for the purpose for which the institution was established, shall be exempt from taxatión. The constitutionality of such statutes is almost universally upheld even in states in which unfiormity of taxation is required, on the ground that such institutions perform a work which would otherwise have to be carried on by the public at the expense of the taxpayers, and that the exemption of such institutions from taxation lessens rather that increases the burden upon other taxpayers." (26 R. C. L. 316.)

In drafting the said clause of exemption in behoof of charitable, benevolent, religious and educational institutions the lawmaker was not concerned at all about the means, the **modus operandi** that might be employed by the corporation for the attain-

ment of its ends or purposes; **that** was a matter of indifference to him; what was essential was that its revenue should not contribute toward the enrichment of third parties, and that the corporation should apply ALL ITS NET INCOME to its corporative purposes, namely, to charity, benevolence, religion and education.

Should the construction given by the petitioner to the Act of Congress of October 3, 1913, prevail, all corporations of the nature of the respondent would, sooner or later, be paralyzed in respect to the exercise of their benevolent activities toward mankind, for their present temporalities, turned unproductive, would be insufficient to maintain the charitable work of the corporation for an unlimited period of time, the commendable purposes sought to be realized would be unattainable and the corporation would be irremissibly condemned to suffer complete exhaustion which would, sooner or later, compel it to lose its corporate existence to the detriment of those who now receive benefits from it.

For the maintenance and development of those benevolent activities of the corporation, and in order that this latter may and might fulfill its purposes and carry them fully into execution,—which is the object or reason for which it was organized,—it necessarily has and had to obtain from its temporalities, in the manner permitted by law, the income that it needs for the attainment of purposes of such magnitude as are those that it proposed to obtain upon its organization, and to contend that by doing so, that is, by putting its real and personal properties upon a revenue producing basis, it ceases **ipso facto**

to possess the conditions necessary to entitle it to exemption from the income tax, would be tantamount to an annulment of the exemption which the law expressly establishes for that kind of corporations, inasmuch as it is impossible to conceive how corporations of this nature could exist if they are bereft of the economical means or sources from which they lawfully derive the necessary receipts to meet their multiple and very considerable expenses of maintenance so as to be able to fulfill their corporative purposes. In other words, the theory of the appellant is that, since, to have income, profits or earnings, corporations of the nature of that here concerned conduct transactions which, though lawful, are for purposes of gain, they are not entitled to exemption, while on the contrary, if their capital remains unproductive, they may rightfully claim exemption. Under the premises we would ask: From what is a religious corporation, that has no income, declared to be exempt? What benefits accrue to a charitable, benevolent, religious, educational or scientific corporation by the laws declaring it to be exempt from the payment of the income tax, if, from the moment it obtains any profit or earnings, (income) from its properties, it loses its right to said exemption?

> "The rule of strict construction will not be pushed to the extent of unreasonableness. It is the duty of the Court to ascertain and carry out the intent of the legislature." (26 R. C. L. 314.)

## ADMINISTRATIVE RULINGS

Under this heading the petitioner reports the similarity of Article 517 of the United States Treasury Department regulations with that contained in the Law of 1913 (Re-Income Tax); the rule laid down by the Bureau of Internal Revenue, United States Treasury Department; as well as the paragraph 3, Section 231 of the Law of 1918 with its corresponding rule of the aforesaid Bureau.

A discussion of the cases cited in this chapter would be superfluous for the simple reason that none of them is derived from any decision of this Honorable Court, they being mere opinions of the Solicitor of Internal Revenue of the United States. Although we do not deny, but, on the contrary do consider that the opinion of the officer charged with the enforcement of a particular law has a certain preponderance and even legal weight in the doubtful cases submited to his resolution, as has been held in the case of "U. S. vs. Hill," 120 U. S., 169, still the Supreme Court of the Philippines has also declared in the case of U. S. vs. Toribio," 15 Ph. R., 85, that:

> "Where the language of a statute is fairly susceptible of two or more construction, that construction should be adopted which will most tend to give effect to the manifest intent of the lawmaker and promote the object for which the statute was enacted, and a construction should be rejected which would tend to render abortive other provisions of the statute and to defeat the object which the legislator sought to attain by its enactment."

and this is precisely what occurs in the present case

where the petitioner is of opinion that the respondent corporation is not exempt from this tax from the fact that, among its temporalities, it possesses shares, real estate and personal properties, and sells some merchandise; in other words, because it has temporalities that bring it profits, and this according to the petitioner, indicates that the corporation is not organized nor does it operate exclusively for religious, educational or beneficent purposes, for such reason for exemption, he argues, should be exclusively interpreted in the sense that it may not have nor obtain income, products nor benefits from its temporalities.

That theory, put into practice, would mean that religious, educational or charitable corporations could not be the owners of nor hold temporalities, unless these were improductive which is wholly contrary to equity and justice.

This manner of construing the law seems to us to be narrow in the highest degree, arbitrarily strict and decidedly contrary to the rules of legal hermeneutics, and, as a final result, to tend to render illusory and inefectual the purpose the legislator sought through the enactment of the law.

> "In the case of "Haydenfeldt vs. Daney Gold Mining Company" (93 U. S., 634-638) it was said: "If a literal interpretation of any part of it (a statute) would operate unjustly or lead to absurd results, or be contrary to the evident meaning of the act taken as a whole, it should be rejected."

And we say that such a narrow construction renders the legislator's true porpose illusory, inasmuch as it is rational that **without** temporalities, that is,

without material means of subsistence the existence of such corporations cannot be conceived, for these, in order to subsist, must not consume their properties, but preserve them, make them productive; their very existence, to put it plainly and tersely, depends upon their obtaining profits from their temporalities.

Neither the intent nor the spirit of the law could have been to make the life of such corporation impossible or to convert them into **mortmain** or to leave them dependent upon mere acts of charity for the maintenance of their own charitable designs.

Such strong stress is laid upon the fact that the respondent is not entitled to exemption because it owns real estate, stock of the Bank of the Philippine Islands and other companies and obtains income from the capital so invested, that it may not be amiss to suggest, at the outset, that statutes of exemption, like all others, are to be so construed as to give effect to the plain intent of the legislators.

> "The rule stated is of course subject to the limitation that statutes creating exemptions are not to be so strictly construed as to defeat the obvious intention of the legislature in creating them". (Am. & Eng. Enc. of Law, Vol. 12, pag. 305.)

> "The construction instead of being strict, is liberal; doubtful expressions, instead of being resolved in favor of the United States, are to be resolved in favor of a weak and defenseless people, who are wards of the nation and dependent wholly upon its protection and good faith. This rule of construction has been recognized without exception,

for more than a hundred years and has been applied in tax cases. (26 R. C. L. 314.)"

This American rule has been adopted by the Supreme Court of the Philippine Islands in the case entitled "The Roman Catholic Apostolic Church in the Philippines vs. Hastings, etc. "5 Ph. R. 701, wherein it said:

> 1. STATUTORY CONCTRUCTION: EXEMPTION STATUTES'—Statutes exempting charitable and religious property from taxation should be construed fairly though strictly and in such manner as to give effect to the main intent of the lawmakers.

We have already stated in this brief that the character of the respondent corporation must be determined from its charter or the law under which it was incorporated and the petitioner's brief sustains our contention, **vide** page 17:

**Paragraph 12, section 231 of the law of 1918, reads:**

> **"Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title."**

**In Office Decision No. 60, U. S. Bureau of Internal Revenue (Cumulative Bulletin, December, 1919, Income Tax Rulings, page 193), it was held that:**

> **"A railroad company, which turns all of its income over to a charitable institution as**

**a dividend does not come within the provision of section 231 (12) as it is actively engaged in the operation of a railroad system."**

From the preceeding quotation it fully appears that the railroad company was organized for the exclusive purpose of holding title to property and consecuently it was engaged in the operation of a railroad system, but that is not the case at bar since from the submitted facts, it plainly appears that the respondent corporation was constituted under sections 154 to 164 of Act. No. 1459 of the Philippine Commission, and is organized and operated for religious, beneficial, scientific and educational purposes in these Islands and in its Missions in China, Cochinchina and Japan, and that neither its net income nor part of its rents from whatever source it may come is applied to the benefit of any particular stockholder or individual, or of any of its members, and that no part of the whole or of some of its temporal properties belong to any of its members, who have no rights to the same even in case of dissolution of the corporation, therefore our theory is sustained by the petitioner itself.

Not a single case is quoted in the petitioner's brief whereby it might appear that the Supreme Court of the United States has ever decided that the income of a corporation sole, of the characte of that of the respondent, is not exempted from the income tax, and without fear of incurring in error, we may say that the lack of jurisprudence supporting the petitioner's contention is due to the fact that organizations in United States similar to that

of the respondent in this case have been granted and have been enjoying the benefits of the exemption established in their behalf in the income tax law, and, naturally, never has such an erroneous contention as that argued in this case been the subject of any action to be determined by the highest Court of the nation.

The respondent, however, has some legal decisions in his favor and against the petitioner's contention, and so we have the case of "Book Agents of Methodist Episcopal Church vs. Hinton," (19 L. R. A., 289), the plaintiff being an institution created for religious and charitable purposes, which employed its capital in the business of the edition and sale of books, the proceeds so derived having been employed by it, in turn, exclusively for religious and charitable purposes. In this case we have just cited the Federal Supreme Court set forth the following conclusions:

> We are of the opinion that the plaintiff is an institution created for both religious and charitable purposes, that the ultimate use of its property has been in accordance with these purposes, that the income and profit derived from the use of its property have been exclusively applied to religious and charitable purposes, and hence it is entitled to exemption, under the provisions of the Constitution and Act.
>
> Held, that credits and notes belonging to a religious society, the income from which is applied to educational, religious and charitable purposes, are exempt. (115, 20 S. E. 626.)

The petitioner cites the case of "Maryland Cas-

sualty Co. vs. United States," 251 U. S. 342-385, where the court said:

> "It is settled by many recent decisions of this court that a regulation by a department of government, addressed to and reasonably adapted to the enforcement of an Act of Congress, the administration of which is confided to such department, has the force and effect of law if it be not in conflict, with the express statutory provision."

That is exactly our contention, that the opinion of the Solicitor of Internal Revenue if applied to the case at bar would be **in plain conflict** with the express statutory provisions of the Law.

## CONCLUSION

In concluding, we respectfully sumit:

That if the respondent, by having effected its organization, in accordance with the legal provisions regulating the creation of religious corporations, has complied with all the requisites of the law; has done nothing that it is prohibited to do and if no part whatsoever of all the income, be its origin what it may, that it has obtained and does obtain, has possessed and does possess, inures or has inured to any private stockholder or individual for his benefit, and if none of its temporalities, totally or partially, belong to any of its members, they having no rights whatever therein, even in case of the dissolution of the institution, then such organization IS A CORPORATION THAT, IN ACCORDANCE WITH

PARAGRAPH G OF THE ACT OF CONGRESS OF OCTOBER 3, 1913, IS EXEMPT FROM THE INCOME TAX.

In view of the foregoing considerations we respectfully ask this Honorable Supreme Court that the judgement of the Supreme Court of the Philippine Islands be affirmed.

Respectfully submitted,

**GABRIEL LA O**

*Counsel for the respondent.*

Manila, Philippine Islands, August 1923.